THE TRUSTED ADVISOR

THE TRUSTED ADVISOR is our firm's regular publication, featuring not only articles and insights derived from our project work but also guest posts and interviews with leading business figures.
They offer food-for-thought and practical advice on a variety of key topics in the leadership, ownership advisory, governance and strategy domains.

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The success factor “external manager”

External filling of management positions in family-owned companies

by Andreas von Specht

1. **Recruitment challenges**

Less than half of family businesses are likely to hand over the reins to a next generation of managers from within the family itself. Many owner families are simply running out of young talent. But even if there are children or grandchildren, this does not mean that they have the aptitude or experience to take over the business.

While the sale of the entire company may be considered by some family businesses without an internal successor, this option is still not desirable for many families. So, if a succession within the family is not possible, or a gap until the next generation is ready has to be bridged, the ‘external management’ option inevitably comes into play.

More and more family companies are deciding to hire managers from outside the family to take on the operational management of their companies. Yet for many there is still uncertainty as to how such a process should be professionally organised and in a way which does not simply rely on “gut feeling”. Mis-hirings of important management functions with external managers are frequent and can be very expensive. They can also lead to a damaged image in the eyes of customers, suppliers and employees. Experience with, or a cultural fit to, SME businesses, and especially family businesses, is crucial. In our consulting practice, we have heard of numerous external managers who did not really understand the values and objectives of the owning family – and were therefore unable to align themselves and perform accordingly.

In order to carefully prepare for the recruitment of an external manager, the shareholder group must first gain clarity about the tasks, distribution of competencies and responsibilities of the top management function. It will be difficult to win over a first-class professional manager for the company if the family is not prepared to cede to the manager significant room for manoeuvre and decision-making authority. The definition of a role profile naturally also includes the question of which “critical competencies” an external manager must bring with him/her. Here it is not only a question of years of experience, but also of the development of certain fields of competence, for example: the ability to develop and implement strategies, to introduce change into the company, or to engender a strong “customer orientation” within the sales team. In order to be able to agree on this competence picture, the family should be guided by what specific results will be expected of the external manager in the coming years, and by how the success of his/her activity will be measured.

2. **Success factors for external managers in family businesses**

The successful “fit” of many external managers in family businesses is often decided after only a couple of brief meetings. There are a large number of family businesses that have been dissatisfied with the first appointments of external managers to their top team. In many cases, it turned out that the family had not devoted sufficient care and time to interactions with the new hire, either before or immediately after the appointment. Family businesses often have unique sensitivities or ways of doing things, which the newcomer inadvertently overlooks or transgresses – and which would not immediately lead to a conflict in large companies but send out an alert signal in the Mittelstand environment. For example, the choice of the “wrong” company car brand, office equipment that was perceived as “too expensive” or an “exaggerated self-portrayal” in public. Many family businesses also expect the outside manager to move to a (small city) location with their family at short notice; here too, misunderstandings and timing can cause problems. So, in addition to a good integration & onboarding process, close personal contact and continuous, open communication is of great importance. According to studies, personal conflicts between family members and the external manager are much more likely to contribute to the failure of the manager than a shortfall in his/her professional qualifications – and these conflicts usually arise at the beginning of their tenure.

A further, essential success factor hides behind the question of successful ‘governance’. A careful definition and organisation of the owner function, for example supported by a competent advisory board, provides a necessary framework within which the external executive can manage – and be managed. Particularly during the transition from an owner-managed to an externally managed company, friction often occurs if the owner side of the equation is not appropriately and professionally set up. Non-family advisory board members, in particular the chairman of the advisory board, often play a key role, as they can act as ‘bridge builders’ ensuring mutual understanding between family and management.

The role of external managers in family businesses depends not least on their personal ties to the entrepreneurial family and their behaviour towards them. There seem to be some unwritten rules that clearly influence the success of outside managers in family businesses. For example, the advice to keep a certain social distance to the owner family and not to strive for the membership in the same clubs or associations. Or the requirement to treat shareholders of different tribes as equally as possible in order not to get caught between two sides.

3. The long-term commitment of external managers to family businesses

In solving the problem of non-family succession, there is also the challenge of motivating outstanding external managers to stay in the company for an extended period and to act in a long-term manner. Too often, bonuses are seen to be handed out according to ill-defined terms and “in the manner of a landowner”, although there has been a professionalisation of the incentive systems in family businesses in recent years with quantitative values more often used as the basis for assessment.

In our consulting practice, we have seen cases where equity investments were considered as an element of the remuneration package – and then actually implemented. There are some major obstacles to overcome, especially the psychological barrier of many families to ever include an outsider in the circle of shareholders and to grant him/her corresponding rights. The structuring of a participation is difficult: the balancing of the participation relationships must be taken into account, the actual share valuation must be comprehensible and fair, and ultimately the details of the transfer of capital shares (e.g. inheritability of the shares or retransfer of the shares upon withdrawal) must be regulated. We recently advised a family business in which all these challenges proved to be surmountable after the family had made the – initially difficult – basic decision to transfer capital shares to an external manager. This fundamental choice was based on the fact that doing so would enable the attraction of a much higher calibre of CEO candidates. Executives who would certainly have wavered beforehand given the company’s size and existing compensation systems, could now be interested in a long-term perspective of genuine entrepreneurial participation.

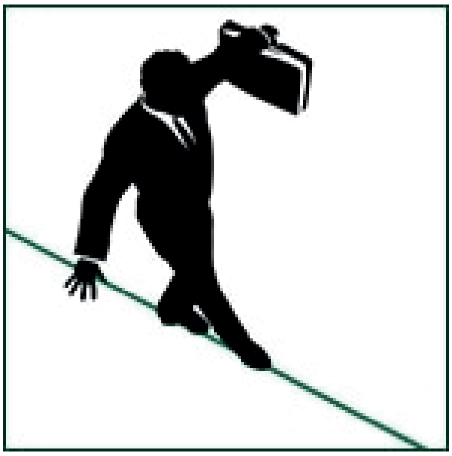
There are undeniable difficulties in implementing an external manager's equity stake, and the administrative and cost implications of implementation are not insignificant. However, this should not lead to a premature rejection of this option, as there are also enormous opportunities to win over real entrepreneurs for the greater long-term development of the company.

If family businesses can succeed in attracting and integrating well qualified and highly entrepreneurial professionals into their companies, these incomers can be the decisive factor in sustaining and improving business success.

A Blessing or a Curse

Family members in management (1): Challenges and risks

by Dr. Christian Bühring-Uhlet



Most family businesses are still run by members of the owner family(s), often with great success over generations. However, many also fail in this task, and some, even without failing in the business dimension, are unhappy in a complex role which they consider to be an “ungrateful task”. And this is not only a problem for the affected family manager, but often an existential question for the company. The typical competitive advantages of family businesses – short decision-making paths, long-term thinking, a clearly formulated mission, high employee identification with the company, better handling of risks, putting the interests of the company ahead of personal advancement, etc. – can only come into their own if the family business is well managed. Therefore, we would like to highlight some of the problems as well as the most important factors that can determine the success – or failure – of family members in management.

To be a manager in the company of one’s own family is associated with special requirements, because typically one must not only (co-)manage the business, but also “the family” – and everything implied by this apparently simple term. The associated complexity represents a special challenge. Some family managers are overburdened because they have not been sufficiently prepared for the management tasks they carry out and may simply be unqualified. In addition, there can be a range of issues and negative feelings including “loneliness at the top”, a (rarely admitted) sense of being over-burdened, poor decision-making, demotivation and fluctuation in middle management, a lack of trust, “trench warfare” in the family – and a struggle for the recognition and trust of other family members. This may go hand-in-hand with a lack of management ability which, in the worst-case scenario, can run through an entire organisation.

Especially in family businesses, there are prime examples of the “Peter Principle”, i.e. that managers are promoted until they reach the level of their own incompetence and are thus inevitably overtaxed. On the one hand, this applies to family members who are entrusted with management responsibilities not because of their qualifications but because they belong to the family (and are then, of course, regarded with suspicion by other executives). On the other hand, there are often also non-family managers who have proven themselves primarily as “faithful servants of the family” rather than competent business leaders (and this also does not escape the notice of other executives, especially top performers).

Mediocrity has a tendency to take hold, with the phenomenon of the “pulley block” being observed: mediocre managers attract mediocre team members who do not question them or pose a threat to their position. Nobody gets hurt but a dangerous comfort zone – often confused with a good working atmosphere – is created. As long as the company is doing well, these conditions are consciously or unconsciously tolerated by the shareholders, i.e. the “family”. The longer this condition persists, the more dangerous it becomes: sometimes an ‘addiction problem’ arises where the affected family member becomes increasingly dependent not only economically but also psychologically on the family business, and the role and status which it confers on them.

When times get difficult, there is often a calamitous lack of adaptability and incompetent family managers fall into a deep hole. In addition to the drama of professional failure, there is the feeling of having failed in front of the family and of having risked the legacy of their ancestors. And if the affected person then has to look for a new job externally, they may suddenly find that they are considered “unemployable” in the ‘real world’. The challenge then arises to find a face-saving task for the affected family member that corresponds to their actual abilities and through which a valid contribution to the success of the company (if it survives the crisis) can still be made.

In the article “Navigating the Minefield”, which follows on from this article, we turn to the precautions that can be taken to deal with these problems and to avoid the “pathology” of the family business.

Navigating the Minefield

Family members in management (2): Success factors and advice

by Felix B. Waldeier

In the previous article “A Blessing or a Curse”, we dealt with the typical challenges, problems and risks faced by family members as managers in their own family businesses. In order to avoid such critical situations for the company – and for the family members working within the business – clear structures and rules of the game are required. At the latest in the second generation, a family business must clearly separate the roles and responsibilities of owners and management. First of all, the basic understanding and attitude with which the family members perform these tasks is important. This is easier with family members who are only owners or managers. In many cases, however, someone is both a (co-)partner and a manager in their “own” company. In this scenario, it is important to adapt one’s behaviour to whether one is wearing the “partner’s hat” or the “manager’s hat” at a given moment. This is much easier if appropriate corporate governance structures are created.

The supporting pillar of these structures should, as already described elsewhere, be primarily an advisory board or, depending on the legal framework, another appropriate supervisory body. The advisory board is the central instance in which the interests of the shareholders are discussed, decided and communicated to the management. The advisory board is the forum in which the company is seen, evaluated and aligned from the perspective of the owners (and thus “the family”). To this end, the advisory board does not necessarily have to be “armed” by transferring essential shareholder rights. If the circle of shareholders is clear enough or is made capable of action by a shareholders’ committee, a considerable leap in quality can be achieved if the topics are analysed, evaluated and thought through in a professionally staffed advisory board. The final decisions can then be left to the “owner”.

Another essential element in the structure of family businesses are the contracts of the family members working in the company. It is highly recommended that they stand up to a third-party comparison, i.e. that family members do not receive a “free meal” and must be measured against the same standards as non-family managers. The comparison should be made with corresponding managers from other companies. Especially when using external managers, equal treatment of these and the family members is highly recommended and should therefore also be ensured by an advisory board made up of respected, competent and external members. This is not only about ensuring an appropriate level of performance, but also about strengthening the credibility and “standing” of the family member as a manager. A high degree of transparency is important here (instead of, as is sometimes still found in family businesses, an almost compulsive “secrecy”): the more openly the matter is handled, the higher the confidence of the other managers – and the other family members – in the performance of the family member active in the management of the company.

A further important point is a systematic succession and talent management approach which includes the appropriate preparation of family members before entering the management of the company. Of course, this includes relevant training but, in our experience, it is also beneficial (almost essential) to gain work experience outside the family business. This is not only about broadening your horizons and gaining management experience, but also about qualifying for management tasks beyond the protection of the family interest. This is a filter in the selection process, but also an important source for the self-confidence of the junior manager, and for their reputation in the family business vis-à-vis employees and family. If the junior manager then continues his or her career in the family company, care must be taken to ensure that he or she is faced with real and growing, but also "achievable" challenges. It must be possible to make mistakes, but failure "in front of running cameras" must be avoided.

From the perspective of the family member working in management, there are a few useful rules of thumb. It is helpful to consciously deal with the different spheres – e.g. the management, the advisory board, the shareholder circle and the family – in which the family manager operates. Of course, there are overlaps between these spheres and some people belong to more than one of them. However, it's important to separate these spheres intellectually and to adjust to each individually. One is – rightly – a somewhat different person when one tackles a day-to-day operational problem in a management meeting versus the consideration of a strategic trend in the Advisory Board. Or if you explain to a passive member of the shareholder circle what is going on in the company (e.g. why the profits unfortunately have to be retained next year), versus sitting with the family at the kitchen table.

Another helpful rule of thumb is to deal consciously with emotions – both your own and those of other family members and stakeholders. Emotions play an important role in family businesses and in order to manage them you have to accept and understand them. Communication is of central importance in any case, but especially in family businesses because the family is so important for the company, and vice versa. And there are typically a number of people who are interested in something they don't understand and where they want to have a say – and often are allowed or even obliged to have a say. Those who do not communicate carefully, respectfully and frequently will be tripped up sooner or later. Trust plays an important role. Those who want to be successful in a family business have to learn to earn trust, to reward trust, to claim trust and to give trust. This is in close interaction with good communication and a good handling of emotions. And it helps combat the feeling of "CEO-loneliness". What also helps in this context is mentoring and the exchange with peers. Many family entrepreneurs find great benefit and solace from networks and business associations that consciously promote such an exchange.

Last but not least: You also have to make the jump. Great entrepreneurial achievement is not only building – but also handing over. Think about what you want to do next, find the right time to hand over the reins with a good feeling, and consciously prepare for that moment.

Allrounder with high social competence

Why the demands placed on chairmen of advisory boards are particularly high

by Andreas von Specht

With around 15.5 million employees, family businesses account for around 60% of all jobs subject to social insurance contributions in Germany. They thus form the economic backbone of Germany and are regarded as the export engine of the German economy. Family businesses are often faster, more direct and much more innovative than corporations. But the processes of change to which German family entrepreneurs have been exposed over the last 20 years are enormous – and have completely redesigned many a business model: internationalisation, environmental protection, technological progress and, above all, the further development of the Internet and e-commerce have required adaptation, change and far-reaching decisions. At the same time, many family-run businesses have experienced a generational transition that has in itself severely challenged or even overtaxed some entrepreneurs. While more than two-thirds of large, non-family owned companies can count on the support of a supervisory board for these challenges, more than half of family businesses in Germany do not yet have such a supporting board. If the advisory councils, which were set up exclusively as disaster protection for the untimely loss of the entrepreneur, were also removed, prospects would look even more critical. Even a few very well-known, globally active family businesses with an annual turnover of several hundred million euros cannot boast any advisory board, or at least not a professional board with decision-making powers and competences.

What at first glance seems incomprehensible and almost negligent for larger companies often has quite mundane reasons: a reluctance to have the business examined or even talked about, a fear of ceding independence, a concern about greater administrative effort or wasting of time. The costs associated with setting up an advisory board are also often cited as a reason for not taking action.

A carefully compiled and well networked advisory board can be worth its weight in gold: as companions, sparring partners, intermediaries between shareholders, and facilitators between shareholders and management. There are, of course, many shareholders with operational activities, but also those who are only interested in accompanying the company. Particularly in the case of important personnel, strategy, or investment decisions, different shareholders often have a clear opinion – but are not necessarily always aligned. A well-positioned advisory board, and above all a well-accepted and respected chairman, is able to find a balance of interests in such situations, to moderate or even to keep rather uninformed or even uninterested shareholders at bay.

The advisory board can play an important role in communicating the values, visions and strategic parameters defined by the shareholders to the management. Above all, however, it can also play an important role in the “calibration” of the entrepreneur himself – who otherwise often has to function “alone at the top” and under pressure of responsibility and decision making. A good advisory board controls, supervises and advises the management and the family. As a neutral authority, it also protects the management against excessive financial demands or power claims of the shareholders. His role can also become particularly important in the often emotionally very difficult succession decisions, where so many families ultimately fail – failing both the business and the family.

The large variety of challenges place particularly high demands on the “all-rounder skills” of the chairman of the advisory board in particular. After all, he should not only actively accompany and control, but also assume responsibility for important decisions in a knowledgeable manner. In addition to a considerable time budget, “general management” competence and leadership experience, empathy, steadfastness and inner independence are also required. As an accepted, respected and as objective mediator as possible, the chairman should ideally already have experience with the specific relationship patterns in family businesses. In contrast to anonymous shareholders, emotions and possibly even heavy “emotional backpacks” from the past can often play a role. At the same time, the chairman in particular must have the ability to recognise and protect the interests of the shareholders even in the case of differing opinions within the advisory board.

This is certainly not a job for a dilettante, but a highly demanding task of great responsibility.

Although the personal liability risk resulting from the legal situation and the public discussion on corporate governance and compliance in the supervisory boards of publicly traded companies has so far been incomparably higher, it is still not possible to assess the risk of liability in the case of the company’s own shareholdings. Fortunately, there is also an increasing professionalisation and at least a significantly increased moral liability in family companies and their supervision. This is a good thing, because the times when the owner recruited his advisory board from tennis partners, Rotarian friends and, if need be, the auditor, should be a thing of the past.

There is no general consensus as to whether the chairman of the advisory board should be delegated from the family or better recruited from the market. For example, there are many successful family entrepreneurs who have seamlessly transferred to the function of the chairman of the advisory board after the generation handover – and who have actually let go of their operative responsibility for day-to-day business. Such advisory board chairmen, such as Jürgen Heraeus (Heraeus), Paul Leibinger (Trumpf) or Michael Otto (Otto Group), then have the invaluable advantage of intimate knowledge of the overall business, the strategic challenges of the market, and the mixed situation within the family. On the other hand, there is also a lot to be said for the advantages of filling the Chairman position externally, because not every full-blooded entrepreneur is good at “letting go”. A strong external chairman of the advisory board is also in demand if the family is more shareholder-oriented than entrepreneurial and, for example, has too little business management knowledge. Or exactly the other way ‘round, if the family has already mastered the entire operative management and a strong, neutral outsider is desired to ensure objective ‘calibration’ and corporate control.

The decisive selection criterion for the appointment of the chairman and the board as a whole must be competence. Of course, trust also plays an important role – but competence and trust usually go hand in hand. In its overall composition, the advisory board should cover specific competencies that are important for the respective family business – such as industry knowledge, strategic orientation, balance sheet security, international business expansion, acquisition experience or talent management.

How do you find and win over such advisory board members – and especially chairmen? With the slowly increasing professionalization of the advisory boards, the professionalization of advisory board searches has also increased. It is often simply not enough to ask friends of entrepreneurs from the region or to search one’s own regional network. Especially since it is by no means guaranteed that the successful entrepreneur who is a friend of the entrepreneur will then also provide an excellent advisory board including the necessary time budget. The big advantage of a professional search carried out by an independent consultant is the broad selection and calibration of competencies. Times have changed here as well: today, even well-known candidates for the chairmanship of an advisory board must put up with the fact that not only are they are interviewed, but they are subjected to a professional selection process. The good news is, the chances of winning an all-rounder with high social competence for the family business should increase significantly.

AvS News

Recent news and developments at AvS – International Trusted Advisors

The past months were marked not only by interesting client projects, but also by exciting developments within our firm that we are delighted to share with you in this edition of THE TRUSTED ADVISOR.

New office of AvS – International Trusted Advisors in Bogotá (Colombia)

At the end of 2014 we opened our second foreign office in Bogotá (Colombia). With continuously good growth rates between four and seven percent, a strong increase in exports and international investments, Colombia has stood out from the rest of the continent for several years. Dr. Christian Bühring-Uhle, who lives in Bogotá, will be a driving force behind the establishment of the office this year and thus lay the foundation for successful cooperation with Latin American clients.

Cooperation with Ernst & Young as part of an international study

Owner families and external managers form a strong team in many family businesses today. But what makes some teams more successful than others? What makes a family business interesting for very outstanding managers in the first place? And where are the crucial sticking points which must be managed to enable a harmonious and long-term cooperation for both sides? Together with Ernst & Young and with the scientific support of ESCP Europe in Berlin, we are currently conducting a study on "External managers in family businesses". A large number of German family businesses with at least 300 employees and an annual turnover of at least EUR 300 million, which are exclusively run by non-family (external) managers, are being surveyed. In order to shed light on the various perspectives, not only these managers are surveyed, but also the owners of the family business themselves. What's special: our study is one of the first to examine this interesting topic! We will inform you as soon as the results are available, and the study has been published.

Late summer reception in Frankfurt am Main

Together with around 70 entrepreneurs, board members and top-class guests, we said goodbye to the last, admittedly somewhat mixed summer on a mild evening at the beginning of September. With a glass of wine and good conversations around our fountain we not only took the opportunity to inaugurate our new garden, but also our new office floor in the mezzanine.

Christmas campaign for young refugee victims from Somalia and Afghanistan

At the end of the year, the crispy geese are taken out of the ovens in many places and a good bottle of red wine is served with them. Not only at this time of year, but especially then, one should pause and think of those who are suffering from war, persecution, oppression or hunger at the same time. In order to escape these torments, people are increasingly seeking protection in Germany – including a group of twelve young refugee victims from Somalia and Afghanistan. They are currently being looked after by the ASB Lehrerkooperative gGmbH in Frankfurt, learning German and experiencing active integration. We were impressed by this project and accordingly we, too, organised by our five student employees, wanted to make our contribution. We were happy to fulfil the young people's wish for a foosball table and not only handed it over personally shortly before Christmas, but also inaugurated it together with them.

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